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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

CASSAN ENTERPRISES, INC., ET AL.,

Petitioners,

v.

DOLLAR SYSTEMS, INC., ET AL.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF *AMICUS CURIAE* OF THE AMERICAN ASSOCIATION OF FRANCHISEES AND DEALERS IN SUPPORT OF PETITIONERS

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I. INTEREST OF AMICUS CURIAE[1]

Amicus curiae, the American Association of Franchisees and Dealers ("AAFD"), pursues the goal of promoting fairness and integrity in franchising throughout the United States. In pursuit of that goal, the *Amicus* promotes the equal application and protection of the law for franchisees and other small business owners who have been injured in business by unscrupulous and unlawful acts of others.

The AAFD has 5,000 members who are franchisees and dealers located in virtually every state. Membership in the AAFD is open to the millions of people who own, or who have an interest in owning, a franchised business, as well as the thousands of companies who seek to do business with franchisees. The AAFD came into existence for the express purpose of providing a counterbalance in the franchising industry, with its mission of bringing fairness to franchising. Among others, the American Bar Association has recognized the AAFD as "a growing force" in the franchising marketplace. *See, AAFD's "Fair Franchising Standards,"* Franchise L.J. 59 (Fall 1996). The AAFD seeks to educate the public regarding fair franchise practices and quality franchise opportunities, and to bring to the consumers' attention the unethical practices that have too long existed in the fran-

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[1] **Rule 37.6 Disclosure**

(a) No counsel for any party authored this brief in whole or part.

(b) Petitioner Cassan Enterprises, Inc. ("Cassan") is a franchisee-member of the Dollar Rent-A-Car chapter of the *Amicus*, the AAFD. As the owner of multiple units, it pays regular dues on an annual basis in the amount of $360. In addition, the Dollar Rent-A-Car chapter of the AAFD has contributed $7,000 to the AAFD to support the AAFD's *Amicus* attorney committee and to pay the costs of printing etc. of this brief. Cassan provided a substantial portion of that contribution.

chising community. By creating a level playing field in which franchisors and franchisees can achieve fair and equitable franchise agreements and relationships, the AAFD expects to help the franchising community achieve its enormous promise.

In this regard, the AAFD is dedicated to marketplace solutions to imbalances that exist within the franchising community. In 1996, the AAFD introduced its "Fair Franchising Standards," a set of comprehensive guidelines for balanced franchise relationships. These standards are a negotiated "work in progress" of the AAFD's Fair Franchising Standards Committee. This committee, made up of franchisors, franchisees, and franchise legal counsel, has been charged with the task of developing standards of franchising practices which balance the legitimate interests of franchisors and franchisees to achieve total quality franchising. The AAFD now offers its Fair Franchising Seal to franchise systems that embrace the AAFD's Standards. Robert L. Purvin, the chairman and founder of the AAFD, is quoted frequently in the press and is a nationally renowned expert in franchising.

The AAFD has members in more than 250 franchise systems, and its membership includes more than 60 active or forming franchisee associations, including, among others, All Tune & Lube, Baskin & Robbins, Carvel, Century 21, Chem Dry, Church's Chicken, Color Tile, General Nutrition, Heavenly Ham, Huntington Learning Centers, Jiffy Lube, Medicine Shoppes, Meineke Mufflers, Priority Management, Radio Shack, Tupperware, Servicemaster, State Farm Insurance, Straw Hat Pizza, Taco John's, and Wedding Pages Magazine Association.

II. INTRODUCTION

This case involves a clearly erroneous interpretation of the "Contract Clause" (U.S. Const., Art. 1, §10) which was used to strike down a state law, the Washington State Franchise Investment Protection Act ("FIPA"). (RCW 19.100.180 *et seq.*) That statute was enacted to regulate the franchising industry in that state, and it "represents a fundamental public policy" of that State. (RCW 19.100.220) It is entitled to greater deference than that afforded by the Ninth Circuit in this case.

The questions presented are:

> Whether a State may regulate a franchisor's performance under a franchise agreement by requiring the franchisor to act in a way that is reasonable and not arbitrary towards the franchisees; or whether, in the absence of the statutory regulation, the franchisor had a contractual right to be unreasonable and arbitrary, and the state statute unconstitutionally "impaired" that contractual right to be unreasonable and arbitrary.

The answer must be that franchisors do not have a right, under any circumstances, to act unreasonably or arbitrarily in their dealings with their franchisees—and that state statutes which codify the franchisor's duty to be reasonable etc. are valid exercises of state police powers that do not violate the Contract Clause.

The Court should grant certiorari, and the decision of the Ninth Circuit should be reversed, for it improperly allows franchisors to hide behind the Contract Clause to avoid compliance with state laws which, in exercise of well-established police powers, seek to regulate well-documented abuses in the franchising industry. This case is all too typical of the misinterpretation of the Contract Clause in the lower courts. Clarification by the Supreme Court on Contract Clause jurisprudence is urgently needed by the fran-

chising industry, and by all other industries that are subject to state police power regulation.

III. STATEMENT OF FACTS: The Landscape of Franchising

Today, franchising—which has its roots in feudalism and in licenses granted by English kings[2]—is one of the dominant means for distributing goods and services in the United States. Franchises employ over eight million (8,000,000) people and account for more than $800 billion in annual sales, or more than 40% of all retail sales throughout the country. *See,* C. Mason-Draffen, *Heaven and Hell: For Some, Franchising is a Dream Come True, For Others It's Their Worst Nightmare,* Newsday, Aug. 28, 1994, at A88. It has been estimated that by the year 2000, franchises may be responsible for over 50% of all retail sales in the United States. *See*, House Comm. on Small Business, 101st Cong., 2d Sess., Report on Franchising in the U.S. Economy: Prospects and Problems (Comm. Print 1990).

While franchisors often present franchising as an opportunity for individuals to become "entrepreneurs," that opportunity generally comes at a high cost and carries with it significant risks. By any measure, the initial cost of becoming a franchisee is substantial. *See, e.g.,* R. Martin, *Studies Confirm, Contradict Conventional Wisdom,* Nation's Restaurant News, Oct. 14, 1996, at 225 (in typical franchise systems, average "initial start-up cost" was $140,000); G. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts,* 42 STAN. L. REV. 927, 934 (1990) (initial investment "ranges from a few thousand dollars to set up a tax service to over half a million dollars for a fast-

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[2] R. Emerson, *Franchising and the Collective Rights of Franchisees,* 43 VAND. L. REV. 1503, 1507 (1990).

food outlet"). *See generally,* R. Purvin, *The Franchise Fraud: How to Protect Yourself Before and After You Invest* (1994).

Part of that cost is generally an initial license fee that the franchisee must pay to the franchisor for the right to use the franchisor's trademarks and tradenames. That fee is frequently non-refundable, even in the event that the prospective franchisee never opens a shop. Upon becoming a franchisee, an individual generally relinquishes control over many aspects of the business to the franchisor. For instance, franchisors often control the use of the trademarks; enact standards for quality control of the relevant goods and services; mandate specific training; set minimum personnel levels; require audits and financial disclosures from franchisees; direct product and supply purchases; and control the content and placement of all system advertising. Typically, the franchise relationship extends for a finite number of years during which the franchisee must pay continuing royalties to the franchisor on some periodic basis.

Further, while many franchisors tout out-dated studies suggesting high success rates for franchisees, the truth is just the opposite. Two recently published university studies commissioned by the Small Business Administration indicate that the failure rate for franchisees is actually *higher* than the failure rate for independent small businesses. *See, Franchising: Golden Opportunity or Risky Business?*, Small Business Advocate 8 (May/June 1996); R. Martin, *supra*, at 225. Within the first five years of operation, *approximately 38% of new franchisees fail and go out of business,* versus a comparable failure rate for non-franchised independent small businesses of only 32%. *Id.* Equally as significant, franchisees in the first five years of operation average annual net *losses* of $4,500, while non-franchised independent small businesses average annual *profits* of $15,500. *Id.*

As one researcher has noted, "[m]ost people think of franchising as some kind of bonanza. . . . The reality today

is if you get a solid operation, work damn hard, and you're making $40,000 a year after four years, that's good." A. Serwer, *Trouble in Franchise Nation,* Fortune, March 6, 1995, at 116 (comments of Ann Dugan, the Director of the University of Pittsburgh's Small Business Development Center). *See also,* W. Grimes, *Perspective on Franchising: When Do Franchisors Have Market Power? Antitrust Remedies for Franchisor Opportunism,* 65 ANTITRUST L.J. 105, 130-31 (Fall 1996) (discussing "the rainbow myth [of high profitability] fostered by franchisor salesmanship"); R. Purvin, *supra.* Moreover, not all franchise systems present the same opportunity to franchisees. Obviously, some franchise systems are more profitable than others. The most-successful 10% of all franchise systems account for almost 75% of all the franchise sales in the United States, while the other 90% of franchise systems share the rest. W. Grimes, *supra,* at 131 (*citing* A. Serwer, *supra,* at 116). One study has found that of the 138 franchise systems launched in 1983, only 25% were even still operating 10 years later in 1993. R. Martin, *supra,* at 225.

According to one 1996 survey, a majority of franchisees are satisfied with franchising and would recommend it to others. E. Shubart, *73% Franchisees "Satisfied": Poll,* Franchise Times (June 1, 1996). However, according to those franchisees who were *not* satisfied, the single largest problem with franchising is "lack of support from franchisors." *Id.* Lack of franchisor support is particularly harmful to a franchisee because of his/her necessary reliance on the franchisor. Although sometimes denied by franchisors, it is a well-accepted fact that franchisors are the dominant party and franchisees are the subservient party in the franchise relationship. Outside of court, "some franchisor leverage over franchisees is widely conceded" even within the franchisor community. W. Grimes, *supra,* at 126. As Circuit Judge Edward Becker recently noted, many "franchisors are leviathans" and franchise "arrangements are clearly onerous to

the average franchisee, a relatively small business person whose sunk costs in the franchise represent all or most of his or her assets and who lacks considerable resources necessary to switch or defranchise." *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 129 F.3d 724, 726 (3d Cir. 1997) (Becker, J., dissenting from denial of rehearing petition). *See also, Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618, 627 (N.J. 1996) ("our common experience" suggests franchisors are in superior economic position compared to franchisees); H.R. 1717, 104th Cong., 1st Sess. (1995) (finding "[m]any franchises reflect a profound imbalance of contractual power in favor of the franchisor"); Va. Code Am. § 13.1-553 (Virginia Retail Franchising Act intended "to correct as rapidly as practicable such inequities as may exist . . . so as to establish a more even balance of power between franchisors and franchisees").

Always in theory and often in practice, franchising can bring profit to franchisors and franchisees alike, and efficiently bring desired goods and services to the consuming public. The benefits of franchising, however, are only realized when franchisors and their franchisees work together, fairly and in good faith, to promote their common interests.

IV. GROUNDS FOR CERTIORARI

A. The Ninth Circuit Decision Reflects Conflict in the Caselaw

Certiorari is necessary to correct an error of constitutional law by the Court of Appeals that, in the first instance, reflects widespread confusion in the federal and state courts concerning the proper application of the "Contract Clause" to regulatory legislation enacted by the states under their inherent police powers. Petitioner Cassan Enterprises, Inc. ("Cassan") has recited this Court's Contract Clause jurisprudence, as well as the confusion in the lower courts on this

issue, at pages 10-14 and 15-24. In addition to the cases cited by Petitioner, the courts in the following cases have upheld retroactive application of franchise regulation statutes, finding that there was no impairment of existing franchise agreements in violation of the Contract Clause. As summarized by Commerce Clearinghouse (CCH) *Business Franchise Guide*:

- *Schieffelin & Co. v. Dept. of Liquor Control, et al.*, CCH BUSINESS FRANCHISE GUIDE ¶8247 (Connecticut 1984) ("Application of an amendment to the Connecticut Liquor Control Act to preexisting distributorships was not an unconstitutional impairment of contract [even] [a]ssuming that the amendment severely impaired the manufacturer's right to terminate distributorships of six months' duration . . . In light of the state's pervasive regulatory power and the manufacturer's reasonable expectations, reduction of the duration requirement could not be regarded as a substantial impairment of contractual relationships. Even if there were a substantial impairment, such impairment would have been justified by the significant and legitimate purpose of the state regulation: to protect distributors from termination without cause and to prevent out-of-state shippers from dominating Connecticut wholesalers. . . .").
- *Nissan Division etc. v. Fred Anderson et al.*, CCH BUSINESS FRANCHISE GUIDE ¶10,292 (N.C. App. 1993) ("Application of an amendment to the North Carolina motor vehicle dealer law, restricting a manufacturer's right to disapprove the relocation of a franchise, did not impermissibly impair the constitutional right to contract of parties to a preexisting dealership agreement. Although the U.S. Constitution forbids states from impairing the obligation of contracts, the right to make a contract remains subject to the state legislature's power to impose restrictions for the benefit of the general public in areas of public interest. In its statement of purpose of the motor vehicle dealer law, the general assembly declared that the distribu-

tion of motor vehicles affected the public interest and welfare of the state and that, in exercising its police power, the state could regulate persons involved in the manufacture and distribution of motor vehicles. The amendment, which provides a procedure by which a dealer may seek administrative review of a manufacturer's refusal to allow a relocation, was a patently reasonable exercise of the state's police power. The procedure would not totally discourage persons from entering into motor vehicle franchise agreements. The amendment could not be said to disturb the core expectations of the contract between the parties.")

The decision of the Ninth Circuit cannot be reconciled with these cases, or with *N.A. Burkitt, Inc. v. J.I. Case Co.*, 597 F.Supp. 1086 (D. Me. 1984) ("Application of an amendment to the Maine motor vehicle dealer law to a preexisting dealership was not an unconstitutional impairment of contract because the amendment . . . did not cause a substantial impairment of vehicle manufacturers' contractual rights. . . . Even if [there was] a substantial impairment of a manufacturer's contractual interests, such impairment would be justified as a valid exercise of Maine's police power. By enacting the challenged amendment, the State of Maine exercised a significant and legitimate interest in regulating business practices to eliminate 'unfair methods of competition and unfair deceptive practices' within the state. Such regulation can foster a more stable business climate for all businesses—thus aiding the state economy—and benefit consumers through prevention of arbitrary and hasty termination of local dealerships.")

The Ninth Circuit did not consider any of these conflicting decisions or engage in any meaningful analysis of the Contract Clause issue. The court perfunctorily affirmed the district court, which had relied principally on an earlier district court case, *Chico's Pizza Franchises, Inc. v. Sisemore*, 544 F.Supp. 248 (E.D. Wash. 1981), *aff'd* 685 F.2d 440 (9th Cir. 1982). The holding in the instant case, like the holding in

Chico, cannot be reconciled with the contrary decisions cited herein, and by Petitioner, warranting Certiorari in this case.

B. FIPA Does Not "Impair" Any Contract "Obligations"

The Ninth Circuit's decision improperly derogates a statute of the State of Washington which that State has held to reflect its fundamental public policy. It thereby derogates the State of Washington's valid exercise of its "police powers" in regulating a key industry, franchising, which affects a large number of persons, constitutes an increasingly important sector of the economy, and is in dire need of appropriate regulatory legislation, as the Washington legislature had determined. Petitioner Cassan argues that FIPA is not unconstitutional because it is a valid exercise by Washington State of its police powers, and that Certiorari should be granted given the confusion that has developed in the lower courts on this issue. The *Amicus* endorses that position, as discussed in Sections (A) and (C) of this argument. Equally important, however, is that this case presents an opportunity to clarify the threshold standard for determing whether there has been an "impairment" of contract:

1. FIPA does not impair any obligation of Cassan, or of Dollar, under the parties' franchise agreements. It merely regulates Dollar's performance of its contractual rights and duties.

2. FIPA does not *substantially* impair any of Dollar's rights. Even before the FIPA was enacted, Dollar had no reasonable expectation of being able to act unreasonably or arbitrarily in its dealings with its franchisees. It was instead subject to a common law implied covenant of good faith and fair dealing, under which it had no right to act arbitrarily, capriciously or unreasonably.

1. To regulate performance does not impair any contract obligations

The Contract Clause, U.S. Const., Art. 1, §10, provides in pertinent part:

> "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."

As a threshold issue, this case presents an opportunity for the Court to correct a serious misapplication of the Contract Clause to state legislation that does not improperly *impair a contract obligation*, but instead merely *regulates contract performance*. This fundamental distinction is plain from the language of Article 1, §10, and is rooted in the Contract Clause's history. As the Court has recognized, the Contract Clause "was made part of the Constitution to remedy a particular social evil—the state legislative practice of enacting laws to relieve individuals of their obligations under certain contracts—and thus was intended to prohibit States from adopting 'as [their] policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them.'" *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398, 439, 54 S.Ct. 231, 240, 78 L.Ed. 413 (1934). Its primary focus was upon legislation that was designed to repudiate or adjust pre-existing debtor-creditor relationships that obligors were unable to satisfy. *Id.*

Here, the State of Washington has validly exercised its police powers to enact a law, FIPA, that regulates the performance of franchisors under their franchise agreements with franchisees, but which does not impair the obligations of the franchisees to the franchisor. The challenged FIPA provisions do not relieve Petitioner Cassan from any of its obligations to Respondent Dollar under the parties' franchise agreement or any other contract between them. Cassan alleges that Dollar violated FIPA, by (1) barring Cassan from leasing GM cars, although other franchisees

were allowed to lease GM cars; and (2) denying assistance to Cassan to maintain a full-service airport rental business, while providing such assistance to other franchisees in similar situations. Cassan alleges that the franchisor's discriminatory conduct in the performance of the franchise agreement violates the provisions of FIPA that prohibit franchisors from "[d]iscriminat[ing] between franchisees . . . in any [ ] business dealing . . . unless and to the extent that that the franchisor satisfies the burden of proving that any classification or discrimination between franchisees is: (i) *Reasonable*; . . . and (iii) and is *not arbitrary* . . . ." RCW 19.100.180.

Cassan is not seeking relief from any of the *obligations* to Dollar that it undertook in its franchise agreement. No obligation of Cassan is *impaired* by requiring Dollar to conform its behavior to FIPA's anti-discrimination provisions. The Court of Appeals' decision to strike down the FIPA simply does not fit within either the plain language or the recognized historical purpose of the Contract Clause.

2. In view of its common law duty of good faith, dollar did not have a "reasonable expectation" of being able to act arbitrarily and unreasonably in discriminating among its franchisees

Secondly, a grant of Certiorari in this case would allow the Court to confirm that the Contract Clause is not violated unless there is a *substantial* impairment of a contract right, and that there is no substantial impairment unless the party claiming impairment had a "reasonable expectation" of receiving the particular contract benefit that would be impaired by retroactive application of the state statute. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983). In *Energy Reserves*, the Court approved a retroactive application of a price control law

enacted by Kansas to invalidate a contract between a natural gas producer and a public utility. There was no question that a price control statute was an impairment of a contract obligation to pay a higher price. However, the state law was not unconstitutional, in the first instance, because the producer did not have a "reasonable expectation" of actually receiving significantly higher prices than were permitted under the price control law. *Id.* The Court stated:

> The threshold inquiry is "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." *Allied Structural Steel Co.*, 438 U.S., at 244, 98 S.Ct., at 2722. *See, United States Trust Co.*, 431 U.S., at 17, 97 S.Ct., at 1515. The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected. *Allied Structural Steel Co.*, 438 U.S., at 245, 98 S.Ct., at 2723. Total destruction of contractual expectations is not necessary for a finding of substantial impairment. *United States Trust Co.*, 431 U.S., at 26-27, 97 S.Ct., at 1519-1520. *On the other hand, state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment. Id.*, at 31, 97 S.Ct., at 1522, citing *El Paso v. Simmons*, 379 U.S. 497, 515, 85 S.Ct. 577, 587, 13 L.Ed.2d 446 (1965).

459 U.S. at 411, 103 S.Ct. at 704 (citations original) (emphasis added).

Here, Dollar and Cassan entered into their franchise agreement in 1967, prior to the enactment of FIPA.[3] However, under *Energy Reserves*, Dollar cannot establish an "impairment" unless it could show that before FIPA, it had a "reasonable expectation" of being able to discriminate *arbitrarily* and/or *unreasonably* against Cassan. That proposition is specious.

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[3] Petitioner's Brief, p. 2.

Specifically, since at least 1966, one year before the Dollar/Cassan franchise agreement, the Supreme Court of the State of Washington has recognized the common law doctrine that there is an *implied covenant of good faith and fair dealing* which is implied as a matter of law in every contract.[4] *See, Miller v. Othello Packers, Inc.,* 410 P.2d 33, 34 (Wash. 1966) ("There is an implied covenant of good faith and fair dealing in every contract, a covenant or implied obligation to cooperate with the other so that each may obtain the full benefit of performance."); *Long v. T-H Trucking Co.*, 486 P.2d 300, 302 (Wash. App. 1971); *Matter of Estate of Hollingsworth*, 560 P.2d 348, 352 (Wash. 1977); *Lonsdale v. Chesterfield,* 662 P.23d 385, 387-388 (Wash. App. 1983) (same).

In the field of franchising, the implied covenant of good faith and fair dealing has been described as a "clever chameleon." Lee Abrams and John A. Donovan, "Clever Chameleon: Good Faith and Fair Dealing," ABA Forum on Franchising, 1995 Annual Forum, Vol. 1, Tab 7. It has been applied by courts in myriad factual settings where franchisors have discretion in performing their contractual obligations or exercising their contractual rights, *e.g.*, the testing of a franchisee's compliance with the franchisor's operational standards; the renewal, transfer or termination of franchise agreements; and the issue of whether a franchised location has been "encroached" by competing franchises, company-owned stores or alternative channels of product distribution.

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[4] The *Amicus* makes no assumption as to whether the particular franchise agreement in this case was subject to Washington law, or whether it contained a choice of law clause requiring the application of another state's law. The implied covenant of good faith and fair dealing is recognized in most states, negating the importance of this point for purposes of the decision whether to grant Certiorari.

In the absence of a statute such as FIPA, the common law implied covenant of good faith and fair dealing would apply to claims that a franchisor has discriminated among its franchisees with respect to its allocation of the benefits of being a franchisee; a franchisor, in exercising discretion as to whether to extend a particular benefit to some franchisees but not others, may be in breach of the implied covenant of good faith which it owes as a matter of law to all the franchisees. *See, e.g. BJM & Associates, Inc. v. Norrell Services, Inc.*, CCH BUSINESS FRANCHISE GUIDE ¶10,485 (E.D. Ky. 1994) (an employment agency franchisee's claim that the franchisor had discriminated against it by excluding it from a bonus commission program offered to numerous other franchisees was tested under the implied covenant of good faith); *see also, Dean v. Kerr-McGee Refining Corp.*, CCH BUSINESS FRANCHISE GUIDE ¶9181 (D. Okla. 1988) (holding that a franchisee's claim that it had been subjected to discriminatory rent increases by the franchisor had been preempted by the Petroleum Marketing Practices Act, 15 U.S.C. §2801 *et seq.*; "but for" that act, the implied duty of good faith would have applied.) Further, the implied covenant of good faith has supplied the standard under at least one federal franchisee protection statute, the Automobile Dealers Day In Court Act, 15 U.S.C. §§ 1221 *et seq.*, for adjudicating claims that automobile dealers have discriminated among various franchised dealers in allocating cars to those dealers. *See, Fox Motors, Inc. v. Mazda Distributors (Gulf), Inc.*, CCH BUSINESS FRANCHISE GUIDE ¶8712 (10th Cir. 1986). In sum, the implied covenant of good faith is irrevocably intertwined with myriad federal and state statutes aimed at the subject of franchisor misconduct, and which seek to regulate the performance of franchisors and franchisees in their contractual arrangements.

Even in *Chico's Pizza*, the earlier district court case that provides the precedent for the instant decision, the district judge recognized that "[i]f defendants had discovered that

Chico's accorded other franchisees perhaps more favorable treatment prior to the passage of FIPA, that realization would have been fruitless *except to the extent such dealings may have been shown to run contrary to a common law requirement of good faith*." 544 F.Supp. at 249-50 (emphasis added). However, despite that insight, the district court in *Chico's Pizza*, and the Ninth Circuit, erroneously ignored the role of the implied covenant of good faith and fair dealing in assessing the franchisor's "reasonable expectations" prior to FIPA.

In sum, long before FIPA, Dollar was subject to a common law duty to act in good faith, which included a duty to be commercially reasonable, in acting under its franchise agreements. The enactment of the statute may have provided the franchisees with additional remedies, but it did not deprive Dollar of any purported "right" at common law to unreasonably or arbitrarily discriminate against Cassan in granting permission to sell GM cars or to support Cassan's effort to maintain a full-service rental business at the airport. Since Dollar had no reasonable expectation of being able to discriminate in an unreasonable or arbitrary manner, it suffered no substantial impairment of any contract right by reason of FIPA. Therefore, FIPA does not violate the Contract Clause. *Energy Reserve, supra.*

C. FIPA is a Valid Exercise of Washington State's Police Powers

For the reasons above, this case provides a much-needed opportunity for the Court to confirm that, where there is not a substantial impairment of a contract right that deprives a party of its reasonable expectations, there is not a violation of the Contract Clause. Moreover, this case presents a further opportunity to confirm that even if there is a substantial impairment, the lower courts must perform a balancing

analysis of several competing interests before concluding that the Contract Clause was offended. As stated in *Home Building & Loan Assn. v. Blaisdell*, *supra*, the Contract Clause is not to be read literally—*i.e.*, not every substantial impairment of a contract right is unconstitutional. 90 U.S. at 445.

It is settled that if the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation (*United States Trust Co. v. State of New Jersey*, 431 U.S. 1, 22 (1977)); for example, the remedying of a broad and general social or economic problem. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 247, 249 (1978). The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests. *Id.* As stated in *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470, 504 (1987):

> [I]t is to be accepted as a commonplace that the Contract Clause does not operate to obliterate the police power of the States. "It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does not prevent the State from exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected. This power, which in its various ramifications is known as the police power, is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals." *Manigault v. Springs*, 199 U.S. 473, 480 . . . (1905). As Mr. Justice Holmes succinctly put the matter in his opinion for the Court in *Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 . . . (1908): "One whose rights, such as they are, are subject to state restriction, cannot remove

> them from the power of the State by making a contract about them. The contract will carry with it the infirmity of the subject matter." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241-242 . . . (1978).

The Washington legislature's decision to regulate the performance of franchisors is a reasonable exercise of the State's police powers, and is necessary to curb well-documented abuses in one of the fastest growing and most important sectors of our national economy, *i.e.*, the franchising industry. As other courts and many commentators have stated, the problems in franchising are a broad economic problem that deserve police power regulation. *N.A. Burkitt, Inc. v. J.I. Case Co., supra*, 597 F.Supp. 1086; *Schieffelin & Co. v. Dept. of Liquor Control, et al., supra*, CCH BUSINESS FRANCHISE GUIDE ¶8247; *Nissan Division etc. v. Fred Anderson et al., supra,* CCH BUSINESS FRANCHISE GUIDE ¶10,292.

In striking down FIPA, both the District Court and the Ninth Circuit failed to engage in the required balancing analysis to weigh the alleged impairment against the legitimate state interests that deserve protection. The Ninth Circuit cited *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992), and *Northwestern Nat'l. Life Ins. Co. v. Tahoe Regional Planning Agency*, 632 F.2d 104, 106 (9th Cir. 1980), cases which acknowledge that a balancing of interests is required, but the Court of Appeals defaulted on its duty to perform that analysis. The Ninth Circuit stated in a single conclusory sentence that FIPA's substantial impairment was not "substantially justified"—a sweeping statement that was erroneous in both its premise and conclusion, and which certainly deserved far greater attention than the Ninth Circuit provided.

From the "landscape of franchising" in the *Amicus'* Statement of Facts, the following conclusions are inescapable: (1) franchising is a growing form of distribution that may soon

affect 50% of all retail sales if recent trends continue; (2) despite many success stories in franchising, franchise relationships are highly susceptible to abusive, opportunistic behavior given the overwhelming economic disparity between the resources of a franchisor versus a typical franchisee; (3) many franchisees have suffered unfairly due to abusive practices by franchisors; (4) an increasing number of jurisdictions have enacted legislation to regulate franchisor conduct and thereby protect franchisees from recurring abuses, such as unreasonable discrimination as alleged here; and (5) the states that have enacted franchisee protection laws have recognized that those laws are a fundamental public policy, as the State of Washington has done here.

Franchisee protection laws such as FIPA are not special interest laws that relieve franchisees of their contractual burdens. Instead, these laws supplement the common law duty by providing countless franchisees with enhanced statutory remedies from arbitrary and unfair conduct that the common law does not permit. As the Washington legislature determined, it is critical that these laws be applied to pre-existing franchise agreements because the typical franchise agreement may last 10, 20 or even 30 years, which is far too long to wait for statutory protection. Moreover, it makes no sense to subject the franchisor to potentially varying legal standards of conduct towards different franchisees depending on when they joined the system. This case will also be of enormous importance if proposed federal franchisee protection legislation, which is currently pending in Congress as H.R. 2954 and H.R. 1083, were to be enacted.

CONCLUSION

In sum, the Ninth Circuit erred in holding FIPA unconstitutional and in giving so little attention to this important issue. For all these reasons, the American Association of

Franchisees & Dealers respectfully urges the Court to grant Certiorari to the Petition of Cassan Enterprises, Inc.

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[5] Mr. Caruso's application for admission to the Bar of the United States Supreme Court is submitted herewith.